

US Trust: Failure to comply w/ requirements
as considered as "cause" for dismissal
under § 1112 and the "reasonableness"
standard of B. Rule X-1007.

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Savannah Division

In the matter of:)	
)	Chapter 11 Case
GEORGE WALTER CROSBY, JR.)	
d/b/a Crosby Brothers Drugs)	Number <u>485-00683</u>
)	
Debtor)	

ORDER ON MOTION TO CONVERT

The United States Trustee filed a Motion to Convert this Chapter 11 case on numerous grounds. After a hearing to consider said Motion I conclude that the Motion should be denied for the reasons set forth herein.

Debtor is the proprietor of a retail pharmacy business. In October 1985 his Chapter 11 case was filed. As of this date Debtor has been unable to propose a confirmed plan. The major reason that Debtor is in this Court and that he has been unable to formulate a plan has been his inability to timely receive medicare/medicaid reimbursements from the State of Georgia for prescriptions he claims to have filled for his eligible customers. At the present time, the vast majority of his customers are medicare/medicaid participants and without a reliable flow in payment of claims Debtor will fail. Debtor's

inability to timely receive reimbursement for medicare/medicaid claims stems from a variety of causes or combinations thereof:

- 1) Debtor has at times lacked a sense of urgency and diligence in filing and substantiating valid claims.
- 2) Worse, Debtor has been the subject of investigation by the State of Georgia to determine whether he has filed fraudulent claims in the past. This could result in a criminal prosecution.
- 3) Debtor's status as a medicare/medicaid provider is the subject of administrative or judicial termination proceedings which if ultimately successful would force him out of business.

No final determination of the criminal matter or Debtor's provider status has occurred. Despite the fact that Debtor had, inexplicably, not timely submitted claims for reimbursement of many thousands of dollars over a period of several months, at a previous motion to dismiss or convert this case, I decided instead to appoint an Examiner, W. Jan Jankowski to serve. The purpose of appointing the examiner was to provide expertise and assistance to the Debtor in processing his claims on a current basis, and in filing claims for services which had

been rendered months earlier. The Examiner has served the estate well and as a result of his efforts substantial sums have been received. By previous order of this Court, Debtor is permitted to retain 25% of all sums received in order to operate his business. The balance is being held in the registry of the Court and amounts to approximately \$111,146.91 at this time.

Given the status of this case, and Debtor's continuing efforts to recover funds I am unable to conclude that the case should be converted under 11 U.S.C. Section 1112 which reads in relevant part:

"(b) . . . on request of a party in interest of the United States trustee . . . the court may convert a case . . . for cause, including--

- (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
- (2) inability to effectuate a plan;
- (3) unreasonable delay by the debtor that is prejudicial to creditors;
- (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;"

As applied to the facts in this case, while each of those criteria arguably exist, a favorable resolution of Debtor's provider status dispute and favorable termination of any criminal

investigation would quite likely enable him to propose a confirmable plan and rehabilitate himself. Indeed, the creditors who appeared at this hearing have asked the Court not to convert the case for essentially two reasons: First, conversion would deprive the estate of the inestimably valuable services of Mr. Jankowski who as Examiner could not serve as trustee or attorney for the trustee by virtue of 11 U.S.C. Section 327(f) and 11 U.S.C. Section 321(b). Second, conversion would reduce the degree of interest, limited as it may have been, of the Debtor in prosecuting his claims and getting his creditors paid.

This leaves the alternative basis for the Motion of the United States Trustee. It is alleged that:

"The debtor has failed to comply with the requirements of the United States Trustee for Debtor-in-Possession in Chapter 11 as authorized pursuant to 28 U.S.C. Section 586(a)(3)."

Nowhere does 11 U.S.C. Section 1112(b) expressly set forth that failure of a debtor to comply with these "requirements" is a basis for dismissal or conversion. However, the general ground for dismissal or conversion is "for cause" and the list of 10 examples under subsection (b) is clearly a non-exclusive listing. Thus, I am faced with the decision of whether a Debtor's failure to comply with the United States Trustee

"requirements" constitutes "cause" to dismiss or convert. Legislative history indicates that subsection (b) grants "wide discretion to the court to make an appropriate disposition of the case." S.Rep.No. 95-989, 95 Cong., 2nd Sess. 117-118 (1978); See H.R.Rep.No. 95-595, 95 Cong., 1st Sess. 405-06 (1977).

In determining whether the failure to comply with United States Trustee "requirements" constitutes "cause" it is necessary to explore what those requirements are¹ and analyze their relationship to the concept of "cause" for dismissal or conversion..

History and Scope of the United States Trustee Program

28 U.S.C. Section 581 provides for appointment of United States Trustees by the Attorney General on a regional basis. The purpose of the enactment of this system was set forth in 1978 when the pilot United States Trustee program was adopted.

¹ The text of these requirements as promulgated in this United States Trustee region are attached as appendix "A" to this Order.

"The second major change proposed by the bill is the creation of a Government officer to supervise the conduct of bankruptcy cases, and to serve as trustee in bankruptcy cases when private trustees are unwilling to serve. Many of the functions assigned to the new official, called the United States trustee, are currently performed by bankruptcy judges. Under the proposed system, the bankruptcy judges will be handling only judicial matters in bankruptcy cases. The proposed United States trustees will be the repository of many of the administrative functions now performed by bankruptcy judges, and will serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena.

The United States trustees will be locally based and generally autonomous, but will be loosely supervised and assisted by the Department of Justice. The bill provides for an Assistant Attorney General, nominated by the President, and confirmed by the Senate, to assist the Attorney General in matters related to the United States trustees. It is expected that the Assistant Attorney General will have only a small staff, and will offer general administrative assistance and support services in individual cases to the United States trustees in each judicial district, where the bulk of the work will be done. Every effort has been made, because of the differences in bankruptcy administration in various parts of the country, to decentralize the United States trustee system, and not to have a Washington-based hierarchy."

H.R.Rep. 95-595, 95th Cong. 1st Sess. 100-15 (1977).

The goal of this system was further amplified in legislative history in 1986 when the United States Trustee program was expanded to a near-nationwide program.

"Ten U.S. Trustee positions were created encompassing 18 federal judicial districts (out of the total of 94 federal judicial districts in the United States). The U.S. Trustees were given responsibility for many of the administrative functions that had previously been handled by the bankruptcy courts (such as appointing individuals to serve as private trustees to handle administrative duties in chapter 7 and chapter 13 cases, monitoring the performance of these private trustees, maintaining panels of private trustees qualified to serve in chapter 7 and chapter 13 cases, appointing a standing chapter 13 private trustee where appropriate, and appointing a trustee in Chapter 11 reorganization proceedings when ordered by the court)

The Department of Justice also issued an in-house evaluation of the Pilot Program 'Report of the Attorney General of the United States Trustee System' (January 3, 1984) which highlighted many of the Program's successes. In particular, the Department emphasized the program's success in carrying out critical watchdog responsibilities, such as preventing fraud and other abuses and in monitoring debtors-in-possession in Chapter 11 reorganization cases to ensure full and timely remittance of employees' social security deductions and withholding tax. The U.S. Trustees have prevented incidents such as one that occurred in a non-pilot district where a Chapter 11 debtor ran up a withholding tax liability in excess of \$1 million."

H.R.Rep.No. 99-764, 99th Cong. 2nd Sess. 15-24 (1986).

Clearly the purpose of the program was and is to separate as much as possible the purely administrative functions formerly performed by the Court from judicial functions, a goal

both salutary and necessary in view of the exploding bankruptcy caseload and expanded jurisdiction of the judiciary. It is clear from the legislative history and the statutory language that all judicial determinations remain with the judiciary. The United States Trustee is an independent agency and comes to court with no special status or presumption that the judiciary views its recommendations or positions with any greater authority or weight than any other litigant. Indeed, the staff of the agency claim no such status in this matter. Nevertheless, it is important that parties who deal with the United States Trustee on administrative matters, and who later appear in court, understand that to be the case.

The "requirements" of the United States Trustee are merely administrative in nature. They have not obtained the blessing of this or any other court as mandatory, court ordered or approved requirements. While they may be extremely useful to the United States Trustee, the Debtor, and creditors in the case, and while debtors may voluntarily comply with them, the determination of whether a failure to comply carries with it any penalty is a matter solely for judicial determination. That calls for an analysis of whether the failure to comply constitutes cause to dismiss or convert, under 11 U.S.C. Section 1112.

United States Trustee Requirements and
the Concept of "Cause"

28 U.S.C. Section 586 sets forth the duties of the United States Trustee. Many of them relate to the appointment and supervision of panel trustees in Chapter 7 cases, and appointment and supervision of standing trustees in Chapter 12 and 13 cases. The United States Trustee is also given the duty to "supervise the administration of cases and trustees . . . under Chapter 11 by, whenever the United States trustee considers it to be appropriate", monitoring creditors committees, applications to employ professionals, fee applications, disclosure statements, and plans in Chapter 11 cases, and reporting to the United States Attorney any criminal violations of the United States law. 28 U.S.C. §586(a)(3)(A),(B),(E),(F) and (H). None of those sections authorize the United States Trustee to impose administrative requirements on debtors-in-possession. Additional duties of the United States Trustee found in U.S.C. Section 586(a)(3) and (a)(5) permit the United States Trustee to:

(a)(3)(D) [take] such action as the United States trustee deems to be appropriate to ensure that all reports, schedules, and fees required to be filed under title 11 and under this title by the debtor are properly and timely filed;

(G) [monitor] the progress of cases

under title 11 and [take] such actions as the United States trustee deems to be appropriate to prevent undue delay in such progress;

- (a)(5) perform the duties prescribed for the United States trustee under title 11 and this title, and such duties consistent with title 11 and this title as the Attorney General may prescribe;"

By its terms subsection (D) authorizes the United States Trustee only to enforce the specific terms of titles 11 and 28 with respect to timely filing of all "reports, schedules and fees." Subsection (G) makes it incumbent on the United States Trustee to monitor and act to prevent "undue delay" in Chapter 11 cases. This duty dove-tails with other provisions such as 11 U.S.C. Section 1112 which permits the United States Trustee to file motions to dismiss or convert if appropriate grounds exist. By its terms, however, it grants no broader regulatory function over the debtor's management of its case than subsection (D).

Section (a)(5) is something of a "catch-all" provision which permits the Attorney General to prescribe further duties for the United States Trustee but those duties are restricted to those which are "consistent with title 11 and this title [28]." Congress granted no broader power to regulate Chapter 11 cases to the Attorney General and the United States

Trustee than that which is necessary to effectuate the policy of title 11 and title 28, as expressed in the Code and Rules. Whatever authority is vested in the United States Trustee to promulgate regulations to carry out its statutory mandate under 28 U.S.C. Section 586 to monitor and supervise the administration of cases is limited by the reasonableness standard of Bankruptcy Rule X-1007, the duties of the debtor/debtor-in-possession as set forth in the Code, and the legislative history. Moreover, the statutory duty of the United States Trustee to supervise and monitor the administration of cases in no way suggests that the requirements promulgated by the United States Trustee are immune from scrutiny by the courts. The enactment of the United States Trustee program did not operate to eviscerate the power and duty of the judiciary to determine whether a failure to comply with the United States Trustee requirements constitutes "cause" sufficient to dismiss or convert a pending case. For such a failure to constitute "cause" to dismiss or convert it must appear that the requirement is a reasonable one. If it is held to be a reasonable requirement, then debtor's violation may be considered, in connection with other factors to determine whether "cause" to dismiss or convert exists.

Reasonableness of the Requirements

11 U.S.C. Section 1107 states that the duties of

a Chapter 11 debtor-in-possession are those set forth for a Chapter 11 Trustee under 11 U.S.C. Section 1106(a)(1),(5),(6) and (7).² Section 1106(a)(1) incorporates as duties of the Trustee the provisions of 11 U.S.C. Section 704(a)(2), (a)(5), (a)(7), (a)(8) and (9). These provisions require in relevant part:

"The trustee shall--

- (2) be accountable for all property received;
- (5) if a purpose would be served, examine proofs of claim and object to the allowance of any claim that is improper;
- (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

² 11 U.S.C. Section 1106(a)(5)(6) and (7) provide that "A trustee shall--

- (5) as soon as practicable, file a plan . . .
- (6) for any year for which the debtor has not filed a tax return required by law, furnish . . . such information as may be required by the governmental unit with which such tax return was to be filed . . .
- (7) after confirmation of a plan, file such reports as are necessary or as the court orders."

- (8) if the business of the debtor is authorized to be operated, file with the court, with the United States trustee, and with any governmental unit charge with responsibility for collection or determination of any tax arising out of such operation, periodic reports and summaries of the operation of such business, including a statement of receipts and disbursements, and such other information as the United States trustee or the court requires; and
- (9) make a final report and file a final account of the administration of the estate with the court and with the United States trustee."

Although the obligations placed on the debtor-in-possession by virtue of Section 704(a)(7) and (a)(8) appear to be open-ended, subject only to a request by the United States Trustee,³ they are not as open-ended as they would appear. Bankruptcy Rule X-1007(b) provides that:

(b) DUTY TO FURNISH INFORMATION TO, AND COOPERATE WITH UNITED STATES TRUSTEE. The trustee or debtor in possession shall cooperate with the United States trustee by furnishing such information as the United States trustee may reasonably require in supervising the administration of the estate.

³ "Party in interest" includes United States Trustee, 11 U.S.C. Section 1109(b), who may appear and be heard on any issue. 11 U.S.C. Section 307.

The trustee or debtor in possession in a chapter 11 reorganization case, and the debtor in a chapter 13 individual's debt adjustment case when the debtor is engaged in business, shall furnish the United States trustee and file with the clerk regular reports of operation as the United States trustee may reasonably require." (Emphasis added).

Clearly the Code and the Rules recognized as a general proposition that certain reports and information must be provided to the United States Trustee,⁴ but the scope and frequency of such reports is limited by a requirement of reasonableness.⁵ I am unaware of any precedent ruling on the

⁴ See 11 U.S.C. Section 521(3) and (4) which require the Debtor to " . . . cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title" and " . . . surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate . . . "

⁵ See Kelly v. Robinson, ___ U.S. ___, 107 S.Ct. 353, 358, 93 L.Ed. 3rd 216 (1986), holding that "in expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy"; Government of Virgin Islands v. Berry, 604 F.2d 221, 225 (3rd Cir. 1979): "All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence. It will always, therefore, be presumed that the legislature intended exceptions to its language, which would avoid results of this character. The reason of the law in such cases should prevail over its letter." quoting United States v. Kirby, 74 U.S. (7 Wall.) 482, 486-87, 19 L.Ed. 278 (1868).

reasonableness of any United States Trustee requirements.⁶ I hold that whether any requirement of the United States Trustee is reasonable must be determined judicially, and not administratively, on a case-by-case basis. This will doubtless result in some lack of strict uniformity in what degree of reporting is required of debtors. However, the vast diversity of this country and of the debtors who seek relief under Chapter 11 mandate an approach tailored to the needs of the particular case. Such a case-by-case analysis is consistent with the legislative

⁶ In re Pappas, 17 B.R. 622, 668 (Bankr. D.Mass. 1982) concerned itself not with the reasonableness of the requirement per se but dismissed a case for bad faith and inability to formulate a plan when debtor had been dilatory and admitted keeping no records of his business operations; In re Cohoes Industrial Terminal, Inc., 65 B.R. 918, (Bankr. S.D.N.Y. 1986) held that failure to comply with United States Trustee operating guidelines is sufficient cause for appointment of trustee rather than conversion. Further reasons in addition to violation of the guidelines were failure to file schedules of assets and liabilities, lack of insurance, failure to pay rent, failure to propose a plan and inability to effectuate a plan; Matter of Denrose Diamond, 49 B.R. 754, 759 (Bankr. S.D.N.Y. 1985): "Though Debtor's post-petition financials fail to satisfy the U.S.T.'s guidelines, no authority for converting a case on the basis of unsatisfactory financial records alone has been called to our attention. In the cases where the court conversion was ordered in the absence of monthly statements, other grounds for conversion existed."

history of the United States Trustee program which contemplated a diverse and decentralized system sensitive to the needs of the particular case and the locality in which the United States Trustee is operating. Some of the factors to be employed in making this determination are:

- 1) The size of the Chapter 11 business.
- 2) The amount and nature of the debts owed.
- 3) The number and sophistication of the creditors of the estate.
- 4) The existence of sufficient staff in the debtor's business to generate the report sought and the required format for the report.
- 5) The timing and frequency which the United States Trustee seeks to obtain the necessary information.
- 6) The underlying causes of the filing of the Chapter 11.
- 7) The nature of the debtor's anticipated plan for reorganization.
- 8) The purpose to be served by each requirement as applied to the specific case.
- 9) Whether the information sought is duplicative of other information available to the United States Trustee and creditors by reference to the debtor's petition, schedules or disclosure statement.

As applied to the facts in this case, Debtor operates a "Mom and Pop" style retail pharmacy, employing fewer than three fulltime employees. His scheduled debts as of the date of filing this case amounted to \$29,236.76 secured and

\$87,287.22 unsecured. Clearly, the imposition of requirements as onerous as those which would be necessary in a multi-million dollar business Chapter 11 case are both unnecessary and unwarranted in a case such as this, where Debtor's business is so small that he could have filed under Chapter 13 had he chosen to do so. Because of the reasons for his erratic cash flow, he would likely have had a difficult time demonstrating that he is an "individual with regular income" as contemplated by 11 U.S.C. Section 109(e). However, he qualifies as an eligible debtor under Chapter 11 as well as Chapter 13. In re Moog, 774 F.2d 1073 (11th Cir., 1985). For this Court to approve carte blanche of identical United States Trustee requirements in all cases would be an abdication of judicial responsibility and would serve to close off meaningful access to the Courts and to the relief provisions of Chapter 11 that Congress clearly intended for small businesses such as this to have. Rather than assisting debtors in reorganizing as Congress intended, unchecked United States Trustee requirements could frustrate Congressional intentions by torpedoing reorganization efforts with onerous paperwork. The promise of a "fresh start" and the guarantee of a reasonable "breathing spell" in which to analyze the debtor's problems and formulate solutions will not be short-cut by administrative decisions that debtors must produce more, at an earlier stage in the case, than Congress required.

Application of the Standards

In this case the United States Trustee established that Debtor has failed to maintain bank accounts and is operating instead on a cash basis. I hold that basic accountability of the debtor-in-possession reasonably requires the establishment of bank accounts as required by the United States Trustee pursuant to 11 U.S.C. Section 704(2) and Bankruptcy Rule X-1007(b). The Debtor was verbally ordered by this Court on October 13 to establish such accounts instanter and said order is hereby memorialized in writing. I do not rule on the question of whether the printed checks of the account must bear the words "Debtor in Possession" as required by United States Trustee requirement number 4.

The United States Trustee also established that Debtor had failed to file an inventory (requirement number 6), had failed to provide proof of insurance on the contents of his business (requirement number 5), had failed to file the United States Trustee "real estate questionnaire", had failed to file a Business Planning Statement (requirement number 17), and had filed his monthly operating statements on the morning of the hearing (requirement number 8).

I hold that United States Trustee requirement number 8 that this Debtor file a monthly operating report showing

receipts, disbursements, and accounts payable is reasonable under Bankruptcy Rule X-1007(b) and 11 U.S.C. Section 704(7). In the case sub judicio the Debtor filed those reports on the morning of the hearing. Although there is authority for dismissing for cause where debtor did not file until the morning of the hearing, [See In re Brauer, 80 B.R. 903 (N.D.Ill. 1987)] I will not convert the case at this time for his prior failure to do so unless the accuracy and sufficiency of the reports is challenged by the United States Trustee. The Debtor is forewarned that his repeated, tardy filing of monthly reports borders on abuse of the Bankruptcy Code and will not be further tolerated. The Debtor is ORDERED to fulfill this obligation in a timely fashion.

Debtor has also violated United States Trustee requirements 5 and 6 by failing to provide a physical inventory of his business and provide proof of insurance. With respect to this Debtor, any requirement for preparing and filing an inventory is governed by Bankruptcy Rule 2015(a)(1) which provides:

"A trustee or debtor in possession shall--

- (1) in a chapter 7 liquidation case and, if the court directs, in a chapter 11 reorganization case file a complete inventory of the property of the debtor within 30 days after qualifying as a trustee or debtor in possession, unless such inventory has already been filed;" (Emphasis added).

Neither the United States Trustee nor any creditor has demonstrated a reason why this Debtor, staffed as he is and with a limited inventory which can be visually inspected at any time, should be forced to stop and do a physical inventory of his business. There is no cash collateral use issue before me or any other matter which demands that the Debtor undertake this burdensome work at this point in time. Accordingly, the Court will not direct the preparation of an inventory and at this time the failure to comply with the United States Trustee requirement does not constitute "cause" to convert.

As to proof of insurance, it appears that the Court has authorized Debtor's landlord to obtain liability insurance and bill the monthly cost to Debtor. The landlord already has the building insured against all risk of loss. The Debtor does not appear to have the requisite three or more employees for whom workers compensation insurance must be provided (O.C.G.A. §34-9-2) and no business vehicles. I find that products coverage is not necessary in this case. Therefore, the Debtor's failure to provide the United States Trustee with proof of insurance has not been shown to constitute cause for conversion.

Requirement number 17 requires Debtor to file a Business Planning Statement which Debtor has failed to do. In a

case such as this one, such a statement is unreasonable because it is burdensome or duplicative of information which Debtor has or will provide in his Disclosure Statement required by 11 U.S.C. Section 1125 and I will not convert the case on this ground. While that requirement may be useful to the United States Trustee and debtors may find compliance to be a useful tool in preparation for their appearance at creditors meetings, failure to comply in this case has not been shown to violate the letter or spirit of the Code and Rules and does not constitute cause for conversion.⁷

Accordingly, IT IS THE ORDER OF THIS COURT that the Motion to Convert is denied on an interim basis. A continued

⁷ While I have ruled that certain of the United States Trustee requirements are unreasonable burdens on this debtor, or if reasonable, constitute insufficient cause to convert this case, Debtor's counsel should not read too much into this order. Just as I have declined to rule that failure to comply with United States Trustee requirements is per se grounds to dismiss or convert, I do not imply that the same requirement would not support dismissal or conversion in another context. The United States Trustee performs a useful, even critical role in Chapter 11 cases. When their requirements are judicially determined to be reasonable, failure to comply will not only constitute grounds to dismiss or convert, but in appropriate cases if debtor's failure to comply is obstructionist or unreasonable, an award of sanctions may well be ordered under Bankruptcy Rule 9011 and 28 U.S.C. Section 1927.

hearing on the Motion to Determine Debtor's Compliance with this
Order will be held on

Friday, December 2, 1988
11:00 o'clock a.m.
Bankruptcy Courtroom, Second Floor
United States Courthouse
Savannah, Georgia



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 23rd day of November, 1988.